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FEDERAL COMMUNICATIONS COMMISSION
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**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.**

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996	))	CC Docket No. 96-150
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	))	DOCKET FILE COPY ORIGINAL

**REPLY COMMENTS OF THE
RBOC PAYPHONE COALITION**

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EXECUTIVE SUMMARY

Attempting to use this proceeding to disadvantage competitors, the American Public Communications Council ("APCC") -- which represents a confederation of non-RBOC payphone service providers ("PSPs") -- has urged the Commission to impose unnecessary and unworkable regulations on RBOC payphone operations. But none of the APCC's proposals would serve the public interest. To the contrary, while the proposals might help the APCC's members by saddling the RBOCs with increased costs and over-burdensome regulations, each of the proposals would harm competition and the public interest that competition serves. The RBOC Payphone Coalition therefore submits these Reply Comments and urges the Commission to reject the APCC's ill-conceived suggestions.

Although unable to argue that the Commission's accounting safeguards have proven ineffective over time, the APCC attempts to articulate four reasons why the safeguards will be ineffective with respect to payphones. None are convincing. First, the APCC argues that accounting safeguards do not prevent discrimination. The argument is nonsense; accounting safeguards are supposed to address cross-subsidies, not discrimination. APCC's arguments about discrimination are thus outside the scope of this proceeding.

Second, the APCC argues that the language of the Telecommunications Act of 1996 requires more rigorous safeguards for payphones. But the Act says no such thing. To the contrary, in the section addressing the contents of the Commission's regulations, the Act expressly identifies <u>Computer III</u> safeguards as the appropriate reference point for the Commission.

Third, the APCC argues that payphones are different from enhanced services as a historical matter. To the extent history matters, payphones are better protected from cross-subsidies than enhanced services were initially because the Commission now relies on an additional barrier to cross-subsidies -- price caps -- which make the accounting safeguards largely redundant. Moreover, the APCC ignores its own argument that there are few joint and common costs between regulated network activities and non-regulated payphone operations, and therefore fewer opportunities for cross-subsidy. Nor does the APCC take into account the fact that RBOCs could never recover their losses in the event they lowered the price of competitive services through cross-subsidies.

Fourth, the APCC argues that the Act increases the opportunity for cross-subsidies by opening new lines of business to the RBOCs. But the APCC ignores the additional regulatory restraints placed on the RBOCs by the Act, and ignores the fact that -- because of the Act -- RBOCs will be under increasing competitive attack in their core lines of business. In such circumstances, the RBOCs can hardly increase rates in their core businesses for the purpose of cross-subsidizing payphone operations.

The Commission similarly should reject the APCC's proposed changes. The APCC's proposal for unbundling every RBOC function -- whether or not related to the provision of basic network services -- is not only outside the scope of this proceeding but wholly unworkable and contrary to the language, structure, and purpose of the Act. The APCC does not identify any compelling reason to adopt its contortionist argument in favor of applying the Commission's affiliate transaction rules to integrated payphone operations. And its proposal that the RBOCs be forced to pay a "royalty" fee for the use of "intangibles" like the RBOC name is inconsistent with the Act, contrary to the Commission's rules and precedent, and blatantly anticompetitive. The primary effect of such a "royalty" would be to increase costs for RBOC PSPs, rendering them less effective competitors. While this might benefit the APCC's members, with whom RBOC PSPs must compete, it would not benefit the public, who would pay more for payphone services as a result of these artificially imposed costs and reduced competition.

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In a thinly veiled attempt to use the administrative process to disadvantage competitors, the American Public Communications Council ("APCC") -- which represents a confederation of non-RBOC payphone service providers ("PSPs") -- has urged the Commission to impose unnecessary and unworkable regulations on RBOC payphone operations. The RBOC Payphone Coalition submits these Reply Comments to urge the Commission to reject the APCC's ill-conceived and unwise suggestions.

I. INTRODUCTION

As various commenters pointed out in their initial comments -- and as the Commission tentatively concluded -- there can be little doubt that the Commission's current accounting safeguards are more than adequate to prevent anticompetitive cross-subsidies. The Commission was "convinced" of their efficacy nearly half a decade ago. See Report and Order, Computer III Remand Proceedings: Bell Operating Co. Safeguards, 6 FCC Rcd 7571, 7595, ¶ 54 (1991) ("BOC Safeguards Order"). The Court of Appeals for the D.C. Circuit has upheld them as "reasonably designed to prevent systematic abuse of ratepayers." Southwestern Bell Corp. v. FCC, 896 F.2d

1378, 1379 (D.C. Cir. 1990). And the Department of Justice has concluded that current FCC cost allocation rules "alleviate the concern that the [Bell Companies] will engage in anticompetitive cross-subsidization of unregulated activities with ratepayer revenues."[1] -- a conclusion that is echoed by the Commerce Department,[2] and by the accounting firm of Arthur Andersen.[3]

Moreover, the Commission's accounting safeguards are, if anything, over-protective, as the Commission's price cap regime (in place since 1990) virtually eliminates any incentive or ability to cross-subsidize. As the D.C. Circuit has explained, "[b]ecause cost savings do not trigger reductions in the cap, the firm has a powerful profit incentive to reduce costs. Nor is there any reward for shifting costs from unregulated activities into regulated ones, for the higher costs will not produce higher legal ceiling prices." National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 178 (1993); see United States v. Western Elec. Co., 993 F.2d 1572, 1580 (D.C. Cir. 1993) (shift to price caps "reduces any BOC's ability to shift costs from unregulated to regulated activities"), cert. denied, 114 S. Ct. 487 (1993). Once again, the Commission itself repeatedly has come to the same conclusion,[4] and the courts have upheld the price caps and accounting

[1]The AT&T Consent Decree's Manufacturing Restriction: Hearing Before the Senate Subcomm. on Antitrust, Monopolies and Business Rights, 102d Cong., 1st Sess. 544 (May 21, 1991) (statement of James F. Rill, then Assistant Attorney General for Antitrust).

[2]National Telecommunications and Information Admin., U.S. Dep't of Commerce, The NTIA Infrastructure Report: Telecommunications in the Age of Information 233 (Oct. 1991) (FCC rules are "extensive and effective in controlling cross subsidy.").

[3]See Arthur Andersen, Calculation of Per-Call Compensation and Review of Accounting and Regulatory Treatment for Payphone Asset Reclassification 13-16 (July 1, 1996) (submitted together with the Comments of the RBOC Payphone Coalition in CC Docket 96-128).

[4]See Report and Order, Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873, 2924, ¶ 104 (1989) (price-cap regulation "substantially curtails the economic incentive to engage in cross-subsidization"); FCC Tel. Price Caps: Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 101st Cong., 2d Sess. 12 (1990) (statement of former FCC Chairman Alfred Sykes) (price cap regulations leave regulated firms with "virtually no ability to pass along cost increases that are within their

safeguards as sufficient to preclude cross-subsidization of integrated LEC enhanced services operations. California v. FCC, 39 F.3d 919, 926-27 (9th Cir. 1994).

The APCC attempts to argue that these conclusions do not apply in the context of Section 276 of the Telecommunications Act of 1996 (the "Act") and the payphone industry as a whole. But none of APCC's arguments has any connection to the payphone industry. None has any basis in the text or history of Section 276. And none will serve the interests of the public or competition. To the contrary, each is calculated to hobble the RBOC PSPs as competitors and increase their costs, thereby promoting the interests of the APCC's members but harming competition and the public interest alike. Each of the arguments therefore should be rejected.

II. Part 64 Safeguards Are More Than Adequate to Preclude Anticompetitive Cross-Subsidies in the Payphone Industry

A. APCC's Arguments About Discrimination Are Irrelevant and Incorrect

The APCC's first argument is that the Commission's Part 64 rules are not sufficient to satisfy the requirements of Section 276 because cost allocation and accounting rules only address cross-subsidies; they do not, the APCC contends, address the problem of discrimination. See APCC at 3. The argument is as irrelevant as it is misguided.

As an initial matter, the argument is beyond the scope of this proceeding. The accounting safeguards of Part 64 are not designed to address discrimination; they are designed to address *cross-subsidies*. Discrimination is addressed by other regulations and remedies. Thus, APCC's argument that accounting safeguards are inadequate because they do not address discrimination is akin to arguing that traffic radar is inadequate because it does not detect parking violations.

control" and drastically reduce the concerns about cost-shifting); BOC Safeguard Order, 6 FCC Rcd at 7596, ¶ 55 (price cap "severs the direct link between regulated costs and prices," thereby "reducing the incentive for the BOCs to shift nonregulated costs to regulated services").

When measured against the risk they were meant to address -- anticompetitive cross-subsidies -- the Commission's accounting safeguards are more than adequate. The Commission, the Courts, the Department of Justice, other agencies, and the experts all agree, and the APCC has offered no convincing reason to think otherwise.[5] To the extent APCC's raises concerns of anticompetitive conduct unrelated to cross subsidies, they are beyond the scope of this proceeding. Instead, the APCC must raise them in the context of proceedings designed to address them, such as CC Docket No. 96-128 (Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996).[6]

In any event, the APCC's argument is misguided because it conveniently ignores the existence of *other* safeguards that do preclude discrimination. For example, with respect to payphones, Section 276 itself provides that the nonstructural safeguards of Computer III will apply. Thus, the RBOCs will be subject to the comprehensive reporting requirements of Computer III and will have to file CEI plans as well. APCC offers no convincing reason why these safeguards, which have proven effective in the context of the enhanced services and CPE, will not prove similarly effective with respect to payphones.

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[5]Although the APCC criticizes the FCC Cost Allocation Manual (CAM) process as severely deficient and recommends additional, detailed requirements, it offers no new arguments to warrant a change in these requirements, which repeatedly have been upheld by the Commission and the Courts. See NYNEX Comments at 9-11. APCC's citation of various alleged accounting audits (APCC at 25 & Attachment 2) only serve to underscore the efficacy of the FCC's rules and demonstrate the regulators' close scrutiny of telephone company books of account. Clearly, the rigorous system of Cost Allocation Manuals, external audits, internal audits, and regulatory audits contemplated in Computer III works. Moreover, the asserted errors would not make a difference in rates under price caps (used federally and in many states), and most were not material in any event. Even if the amounts in question had been misallocated, the effect on rates in most instances would have been lost in roundings. There can be no cross subsidization if rates are unaffected.

[6]Non-payphone discrimination safeguards are addressed in CC Docket No. 96-149 (Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Telecommunications Act of 1996).

B. The Plain Language of the Statute Does Not Require or Even Support the Imposition of Non-Computer III Safeguards

The APCC also argues that the plain language of the statute requires greater safeguards than those imposed in Part 64. In particular, the APCC argues that Part 64 was adopted pursuant to Computer III, in which the Commission balanced the pro-competitive benefits of allowing integration -- greater efficiency -- against the hypothetical risks of discrimination and cross-subsidy. APCC at 3. Such balancing of risks and benefits, the APCC urges the Commission, is impermissible here because Section 276 states that the RBOCs "shall not subsidize" and "shall not discriminate," without mention of any countervailing concerns. Ibid.[7]

APCC's argument is disingenuous. The fact that Congress has included a flat prohibition against subsidies does not mean that the Commission is required to promulgate prophylactic regulations so extensive and over-burdensome as to address even the most remote possibility of cross-subsidy -- regardless of the burden on the Commission, the damage to the RBOCs, or the cost to consumers. To the contrary, the United States Code contains hundreds if not thousands of flat prohibitions against misconduct; yet those prohibitions are regularly enforced through rules and procedures which balance the need for enforcement against the burdens created.[8] Thus, when Congress states that "[n]o person shall" import firearms without a license, 18 U.S.C. § 923, it does not obligate the FBI or the Bureau of Firearms and Tobacco to search every incoming package for firearms to ensure literally that "no person" ever succeeds in breaking the law.

[7]See also id. at 10-11 ("The Commission is no longer permitted, if it ever was, to balance efficiency with subsidization concerns.").

[8]See, e.g., 7 U.S.C. § 2a(v) ("No person shall offer to enter into" futures contracts except pursuant to specified U.S. Code provisions); 7 U.S.C. § 6c(a) ("It shall be unlawful" to engage in cross trades or trades recorded at a price other than "a true or bona fide price"); 15 U.S.C. § 18 ("No person . . . shall acquire . . . the whole or any part" of another company within the jurisdiction of the Federal Trade Commission where the effect may be anticompetitive); 15 U.S.C. § 717b(a) ("no person shall export any natural gas" without a license).

Similarly here, the Commission is under no obligation to take over the RBOC's accounting or impose other costly restrictions to make even the most hypothetical possibility of cross-subsidy literally impossible.

Moreover, while the APCC purports to rely on the "plain" language of Section 276(a), which contains the general rule against cross-subsidies, the APCC conveniently ignores the critical language of Section 276(b), which specifically addresses the *contents* of the Commission's *implementing regulations*. See 47 U.S.C. § 276(b), (b)(1) (subsections entitled "Regulations" and "Contents of Regulations"). In Section 276(b), Congress directed the Commission to use non-structural safeguards, and identified the Computer III safeguards as acceptable to effectuate Congress's goals.[9] Thus, the APCC's argument that Computer III engaged in balancing that is impermissible in light of the "absolute" prohibition of Section 276(a) simply misses the point -- Section 276(b) *itself* provides that the Computer III safeguards are acceptable and thus embodies the philosophy that existing efficiencies need not be eliminated as part of payphone deregulation.

In the final analysis, if Congress had intended to proscribe the pro-competitive and pro-consumer efficiencies that might result from integrated operations -- or to impose a regime that would root out any possibility of cross-subsidy even if it required the FCC effectively to run the RBOCs' operations for them -- it could have ordered the Commission to disregard the balancing criteria used in Computer III and singlemindedly eliminate the possibility of cross-subsidy regardless of social cost. But Congress did no such thing, and by incorporating Computer III as the appropriate reference standard Congress expressly incorporated the balancing of costs and

[9]Subsections 276(a)(1) and (a)(2) contain the prohibition on discrimination and cross-subsidy. Subsection 276(b)(1)(C) specifies that the nonstructural safeguards of Computer III are sufficient "to implement the provisions of paragraphs (1) and (2) or subsection (a)."

benefits that the Commission consistently has employed when establishing regulations designed to promote the public interest.

C. The APCC's Arguments About Differences Between Enhanced Services and Payphones Cut Against the Additional Burdens It Seeks to Impose

In a further attempt to impose additional burdens on RBOC payphone operations, the APCC argues that payphones have a different "history" than the enhanced services addressed in Computer III. According to APCC, the RBOCs started out with zero market share in the market for enhanced services and, as a result, did not require rigorous safeguards. APCC at 4. It further argues that, when the Commission established its CPE Relief Order, the RBOCs also held relatively small shares of the market. Id. at 7 n.3.

Contrary to the APCC's arguments, any sensible look at the "history" of enhanced services and payphone services demonstrates that payphones need *less* regulation. When the Commission adopted its current accounting rules in 1986-1987, the RBOCs were under rate-of-return regulation and the accounting rules were the Commission's primary bulwark against cross-subsidization. Today, however, the RBOCs are all under price caps -- and all but one of them are under the no-sharing option. As a result, the Commission's accounting rules now serve as a *secondary* (and largely *redundant*) protection against cross-subsidies. See pp. 2-3, supra (explaining that price caps remove any incentive or ability to cross-subsidize). APCC's argument that accounting safeguards were sufficient for enhanced services in 1986-1987, when they were the primary barrier to cross-subsidy, but that they are insufficient for payphones in 1996, now that price caps make them redundant, is thus historically myopic if not hopelessly blind.[10]

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[10]Moreover, the Commission now has over a decade of experience with its accounting safeguards, and repeatedly has had the opportunity to refine their application.

Second, according to the logic of the APCC's own arguments, the risk of cross-subsidy is much lower with respect to payphones than for enhanced services. The problem of cross-subsidy generally arises where there are joint and common costs or transfers between regulated and unregulated operations or affiliates.[11] As a result, where joint and common costs or transfers are infrequent, the problem of cross-subsidies is not large. See United States v. Western Elec. Co., 12 F.3d 225, 235 (D.C. Cir. 1993) (cross subsidization "effectively impossible" where there is "no incurring of joint costs, and hence no possibility that costs could be misallocated."). According to the APCC, such is precisely the case with respect to payphones. The APCC specifically argues that (unlike many services) there are few joint and common costs or transfers between BOC regulated network operations and non-regulated payphone operations. See APCC at 9 ("there should be no joint and common use of assets except for, perhaps, some sharing of land and buildings"); id. at 10 ("Other sharing of resources should also be minimal"). It follows that the risk of cross-subsidies is minimal as well; fewer joint costs between payphone operations and regulated activities means, under APCC's own logic, fewer opportunities for cross-subsidization.[12]

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[11]Report and Order, Separation of Costs of Regulated Tel. Serv. from Costs of Nonregulated Activities, 2 FCC Rcd 1298, 1303, ¶ 29-30 (1986) ("Joint Cost Order"), reconsidered, 2 FCC Rcd 6283 (1987), reconsidered, 3 FCC Rcd 6701 (1988), pet. for review denied, Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1379 (D.C. Cir. 1990).

[12]LDDS WorldComm's suggestion (at 10) that the FCC's cost allocation rules are only adapted to the enhanced services market is similarly mistaken. The Commission's cost allocation rules are based on principles of cost causation; they are not based on the nature of the service being provided. See 47 C.F.R. § 64.901(b)(2)-(b)(3). In fact, the nature of the service is wholly irrelevant, since the Commission's rules are designed to address any market in which there is a hypothetical incentive to misallocate costs. The Commission thus envisioned that these rules would be applicable to both network and non-network services. See Joint Cost Order, 2 FCC Rcd at 1299, ¶ 3; id. at 1307-09, ¶¶ 69-81. Moreover, at the time these rules were adopted, not only enhanced services were non-regulated, but so were inside wiring and CPE -- and telemessaging was on the horizon. That the Commission envisioned even greater levels of network integration is clear from the order itself. See id. at 1304, ¶¶ 39-40.

Finally, with respect to the question of market share, APCC claims that the RBOCs dominate the payphone industry but fails to mention that the RBOCs have smaller shares of the competitive payphone market than AT&T has of the interexchange market -- and that the RBOCs' market shares continue to fall. Moreover, the barriers to entry are low and market participants are numerous. For the RBOCs even to consider cross-subsidizing in such a market would be economically irrational, since they have no conceivable hope of ever recovering any losses they incur.[13] Thus, it comes as no surprise that, in an almost indistinguishable context, the FCC already has concluded that its "accounting safeguards with regard to nonregulated service sufficiently protect against the potential for cross-subsidization." Declaratory Ruling, Petition for Declaratory Ruling by the Inmate Calling Service Providers Task Force, RM Dkt No. 8181, at 13, ¶ 27 (rel. Feb. 20, 1996). The APCC provides no reason to doubt that the same conclusion applies here.

D. The Telecommunications Act of 1996 Does Not Increase the Risk of Cross-Subsidization

Finally, the APCC argues that the Act places other lines of business into the "non-regulated" category and thereby increases the potential for cross-subsidization. The APCC would have the Commission ignore the fact that the Act not only authorizes BOC participation in additional markets but also imposes a "judicious mix" of safeguards to preclude anticompetitive misconduct. Thus, with respect to the additional, non-payphone services to which the APCC refers, Sections 251-252 and Sections 271-272 establish an elaborate set of safeguards, including

[13]This would be particularly unwise given the explosive growth of competition in local services that the Telecommunications Act of 1996 is designed to bring. See pp. 10-11, supra. Confronted by a competitive onslaught in their core businesses, RBOCs can hardly cross-subsidize from those businesses to prop up ventures that, like payphone operations, have an uncertain future. Ibid.

the use of separate affiliates in certain contexts,[14] non-discrimination safeguards, 47 U.S.C. § 272(c); id. § 272(e)(1)-(4), the conduct of biennial audits, id. §§ 272(b)(2), 272(d)(2), (d)(3), and special marketing rules, id. § 271(g). The APCC takes none of these new and reinforced safeguards into account when it makes the unsupported assertion that the Act increases the opportunities for cross-subsidy.

Similarly, the APCC's assertion ignores the fundamental restructuring the Act is supposed to effect -- increasing competition in the local exchange market. Subject to competitive attack at this core portion of their business, RBOCs are hardly in a position to charge supra-competitive prices for local services to subsidize other operations, much less operations (like payphones) where the RBOCs' market shares and revenues are on the wane. Indeed, under the Commission's recent Local Competition Order, the unbundled elements on which the RBOCs' local service competitors might rely will be priced based on the most efficient network configuration possible and independent of actual costs.[15] Consequently, any attempt to cross-subsidize -- even if one were to assume that the misallocation of costs inexplicably went undetected and were somehow, despite the use of price caps, miraculously converted into an increase in RBOC prices -- would hurt the RBOCs by giving a price advantage to their burgeoning competitors.

In this context, the APCC's cries of cross-subsidy must be taken with a grain (if not a pillar) of salt. The Commission's accounting safeguards have been proven effective through a

[14]See 47 U.S.C. § 272(b) (BOCs must employ separate affiliate for manufacturing and interLATA services, affiliates must operate independently, have separate books, records and accounts, separate officers, directors and employees, separate credit-security, and must conduct transactions with BOCs at arms-length).

[15]First Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Dkt. No. 96-98, FCC No. 96-325, at B-30 (rel. Aug. 8, 1996) (to be published at 47 C.F.R. § 51.505(b)(1)). Citation of this regulation should not be construed as endorsement thereof.

decade of experience. The Commission's price cap regime removes any incentive or ability to cross-subsidize, making the protections offered by the accounting safeguards largely redundant. And increasing competitive attacks on the RBOCs' core businesses make it exceedingly unlikely that they could profitably increase prices to engage in cross-subsidies even if the accounting safeguards and price cap regimes somehow mysteriously and inexplicably failed. Under these circumstances, there is no conceivable basis for arguing that Congress's faith in the sufficiency of Computer III's safeguards -- incorporated by reference in Section 276 itself -- was in any way misplaced.

III. APCC's Proposals Are Ill-Conceived, Unauthorized by the Statute, and Anticompetitive

After failing to demonstrate the inadequacy of the Commission's accounting rules, APCC then goes on to make some suggestions for improving them. Like its critique of the Commission's accounting rules itself, APCC's suggestions range from the irrelevant to the absurd.

A. APCC's Proposal For Unbundling

Attempting to inject the issue of discrimination into this proceeding, the APCC argues that all operational functions made available to RBOC payphone operations must also be made available to competing non-RBOC payphone providers.[16] This, the APCC argues, is necessary to enforce Section 276's prohibition against discrimination, which the APCC characterizes as being absolute.

The argument is not only beyond the scope of this proceeding, see pp. 3-4, supra, but utterly unfounded. If Section 276 were read as precluding the RBOCs from making *any*

[16]Thus, for example, the APCC asserts that a LEC would be discriminating in favor of its own payphone operations if it did not make its installation and maintenance personnel available to other payphone service providers under the same terms and conditions to perform installation and maintenance of their payphone and non-network wires.

distinctions between the RBOC and its competitors, then the RBOCs would have to offer non-RBOC PSPs not only non-discriminatory access to network services but also access to the RBOC legal department for the provision of legal advice, the personnel department for the handling of hiring, firing, and training of employees, the research and development operations for new product development, and advertising for product promotion. Surely if Congress had intended to create such an operational nightmare -- the effective conversion of RBOCs from independent corporations into a cluster of support departments available *a la carte* to competing PSPs -- it would have so indicated. But nowhere in Section 276 did Congress ever suggest such an intent. To the contrary, the language and structure of the Act demonstrates that Congress *never* intended such a dramatic result.[17] APCC's argument thus must be dismissed for what it is: An improper

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[17]First, where Congress wished the RBOCs to provide access to non-essential services, it expressly so provided in the Act. See, e.g., 47 U.S.C. § 272(e)(4) (BOC can "provide any interLATA or intraLATA facilities or services to its interLATA affiliate" only "if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."); id. § 272(e)(2) (RBOCs "shall not provide any facilities, services, or information concerning its provision of exchange access" to its interexchange affiliate "unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions."). No such provision exists for Section 276 with respect to *any* service (whether it be inside wiring, joint marketing, installation, or other non-network related services). Second, Congress in Section 276 specified that the non-structural safeguards of Computer III are an appropriate model for the Commission to apply in the payphone context. Computer III and the related BOC CPE Relief Order did not unbundle the entire RBOC organizations into *a la carte* menu items from which competitors can pick. Instead, like the Telecommunications Act itself, they addressed the need to provide competitors with equal and fair access to so-called essential or basic network service elements. They thus required RBOCs to provide underlying network functions provided to nonregulated operations under tariffed rates, terms and conditions, and established nondiscrimination reporting requirements to ensure the timely provision of those services. The APCC provides no basis for expanding those requirements to embrace other non-tariffed support functions which a RBOC may provide to integrated payphone operations, but which competitors can obtain competitively or provide for themselves. Third, the level of unbundling proposed by the APCC exceeds that required in any other market. The APCC never explains why Congress would require greater unbundling for payphones -- which have had competition for years -- than with respect to local services or the interLATA services from which the RBOCs have so long been barred.

effort to expand the scope of this proceeding to achieve a result that Congress never contemplated and the Act will not support.

B. The APCC's Proposal for Requiring Application of the Affiliate Transaction Rules to Integrated Operations Is Inappropriate

Unable to twist the statute into a license for the dismemberment and redistribution of RBOC operations to its constituents, the APCC next attempts to require the RBOCs to apply affiliate transaction rules to integrated RBOC operations, purportedly because there will be few common costs between regulated and non-regulated payphone operations. See APCC at 6-10. This would be an unnecessary and unwarranted departure from the intent of the Act, existing FCC affiliate transaction rules, and from the rules adopted in Computer III (which the Act identifies as providing adequate safeguards for deregulation of payphone operations). Nothing in the Act requires the RBOCs to keep a separate set of books, and it is widely known that there are joint and common costs involved in the provision of payphone service. Consequently, the APCC's argument[18] on this score must be rejected, as must the rest of the APCC's unsubstantiated proposals.[19]

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[18]For the same reason, the Commission should reject CompTel's argument (at 19) for revising the rule to achieve the same result. CompTel utterly fails to meet the heavy burden of justifying such a radical revision to the Commission's rules -- or even identifying a problem in need of correction. CompTel's further assertion (at 11) that the prohibition against cross-subsidies extends to the cost of 0+ services or 0+ commissions to site owners is somewhat perplexing. CompTel seems to argue that the cost of "providing 0+ commissions to site-owners" must be allocated 100 percent to non-regulated payphone operations. But CompTel offers no good reason for requiring any particular allocation scheme. Moreover, if such an allocation rule were adopted, the RBOC also would allocate 100 percent of the revenues generated from these commissions to the RBOC PSP; he who bears the cost reaps the return. In any event, the treatment of this issue is best addressed when the RBOCs file revised CAMs to account for deregulation of their payphone operations.

[19]The Commission should not adopt the APCC's unsubstantiated assertion (APCC at 17-18) that general allocators under-allocate costs to competitive lines of business. For one thing, the assertion that LEC CEOs spend more time worrying about payphones, for example, than their

C. APCC's Proposal that RBOC Payphone Operations Pay a "Royalty" for Intangible Benefits is Unsupported and Insupportable

Finally, seeking to impose one last additional cost on their RBOC rivals, the APCC contends that the Commission should require RBOC payphone operations to pay the RBOC a "royalty" for intangible benefits like the RBOC name, reputation, and logo. APCC at 18-21. But there is no support for such an approach in the statute. If Congress had wanted the Commission to impose such a fee, it would have so stated in the Act. It did not. To the contrary, in Section 274(b)(6) Congress specifically addressed the use of Bell Company trademarks, service marks, and names in the context of electronic publishing, and rightfully declined to place any restrictions on the use of marks and names owned not by the LEC but by the holding company.

1. In any event, the Commission (like the vast majority of state commissions) repeatedly has rejected proposals that would require alteration of its cost-accounting rules or the payment of royalties to reflect "intangible benefits," and the APCC provides no persuasive reason for the Commission to alter course.[20] In its Joint Cost Reconsideration Order, 2 FCC Rcd at

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multi-billion dollar public switched networks is positively absurd. For another, the APCC provides no evidence to support its proposed partial use of an arbitrary 50 percent allocation factor. Instead, that figure seems to have been plucked from thin air -- the very essence of arbitrary and capricious behavior. San Antonio v. United States, 631 F.2d 831, 852 (D.C. Cir. 1980) (agency's decision to impose 7 percent rate additive reversed because, even if the agency had a rationale for *some* additional increment, the agency had failed to offer a justification for choosing a 7% rather than "a 1%, 21%, 45%, or even 99% additive"), later proceeding on remedy, 655 F.2d 1341 (1981), later proceeding reversed in part not relevant, Burlington Northern, Inc. v. United States, 459 U.S. 131 (1982).

[20]In a futile effort to demonstrate that royalty payments are the wave of the future, the APCC asserts that "state commission[s] increasingly have recognized the value of a royalty fee mechanism as a means of preventing" cross-subsidy. APCC at 19. But APCC identifies only a handful of jurisdictions (six total) that have adopted royalty payments in any context at all -- omitting mention of the 40-odd jurisdictions that have not adopted a royalty requirement. Thus, the weight of authority is 7-to-1 against the use of royalties, and jurisdiction after jurisdiction -- in cases often more recent than those cited by the APCC -- has *rejected* such requirements. See, e.g., Re Pacific Bell, D. 87-12-067, 27 Cal.P.U.C.2d 1, 136 (1987); Re San Diego Gas & Elec.

6315-16 n.204, the Commission expressly rejected a recommendation that a non-regulated affiliate be charged for the training of an employee that had been transferred to it. As the Commission explained, because employee training is "an intangible benefit" and a "sunk" cost, the value thereof is of no consequence under the Commission's rules.[21]

The Commission again rejected valuation of intangibles when reviewing RBOC cost allocation manuals. Approving Ameritech's refusal to allocate the value of its "name," the Commission observed:

> In the *Joint Cost Order*, the Commission found that intangible benefits, and the allocation of those benefits, was beyond the scope of this proceeding. [Citation omitted]. Although the *Joint Cost Order* provides a mechanism for allocating all of a carrier's costs between regulated and nonregulated activities, intangible benefits, such as the Bell name, are not costs. No cost associated with the Bell name has ever appeared on Ameritech's books.

Memorandum Opinion and Order, Ameritech Operating Companies' Permanent Cost Allocation Manual for Separation of Regulated and Nonregulated Costs, 3 FCC Rcd 433, 437, ¶ 40 (1988).

Co., A. 94-11-013, D. 95-12-108 (Cal. PUC Dec. 6, 1995); In re Southern Cal. Edison Co., D. 88-01-063, 27 Cal.P.U.C.2d 347, 369 (1987); Re Roseville Tel. Co., A. 95-05-031, D. 96-07-059 (Cal. PUC July 17, 1996); Re Wisconsin Power & Light Co., No. 6680-UR-109, 158 P.U.R.4th 80 (Wis. PSC Dec. 8, 1994); Re PacifiCorp dba Pacific Power & Light Co., UE76, Order No. 92-1128 (Ore. PUC Aug. 4 1992); Re Implementation of SB 2320 -- Royalty/Monitoring, Case No. PU-2320-90-737, 123 P.U.R.4th 6 (N.D. PSC May 21, 1991); Re Centel Network Communications, Inc., Docket No. 88-1156, 105 P.U.R. 4th 135 (Nev. July 6, 1989); Re United Tel. Co., Case Nos. TR-93-181, TO-93-309 (Mo. PSC Oct. 27, 1993); Staff of the Missouri Pub. Serv. Comm'n v. Southwestern Bell Tel. Co., Case Nos. TC-93-224, TO-93-192 (Mo. PSC Jan. 1, 1994); Re Baltimore Gas & Elec. Co., Case No. 8577, Order No. 72107, 163 P.U.R. 4th 254 (Md. PSC Aug. 4, 1995); Re Baltimore Gas & Elec. Co., Small Business Coalition for Fair Utility Practice v. Baltimore Gas & Elec. Co., Case No. 8577, Order No. 72208, 86 Md. P.S.C. 325 (Oct. 2, 1995); Re Illinois Power Co., No. 92-0404, 147 P.U.R.4th 225 (Ill. Commerce Comm'n Nov. 9, 1993); Re Potomac Elec. Power Co. (Pt. 1 of 4), Formal Case No. 939, Order No. 10646, 162 P.U.R.4th 417 (D.C. PSC June 30, 1995). Moreover, as explained below, royalty arrangements have nothing to do with cross-subsidies.

[21] In contrast, the provision of employee training services might be the provision of a service subject to cost allocation rules.

Similarly, in 47 C.F.R. § 65.450(c), the Commission specifically addresses the treatment of "assets" (like intangibles) that do not appear as "costs" on RBOC books, and it specifies that they are *not* to be valued or assessed: "Gains or losses related to the disposition of property that was never included in the rate base shall not be considered for ratemaking purposes."

These decisions -- and this rule -- are dispositive. The asserted rationale for this "royalty fee" is to force RBOC payphone operations to "pay" for the use of intangible assets like the RBOC name. But none of those intangible assets are "costs," none have appeared as such on RBOC books, and none have ever formed the basis of regulated rates. Accordingly, the Commission's own rules and decisions preclude their consideration here.

2. Nor does the APCC's rationale for imposing a royalty fee make any sense. According to the APCC, a royalty fee is necessary to "compensate" ratepayers "for the costs that they bore to build the intangible benefits associated with the Bell Company name and logo." APCC at 20. But the APCC nowhere offers any evidence that *ratepayers* rather than *shareholders* paid for the development of intangibles like the RBOC's name and reputation. To the contrary, because those assets never have been part of the ratebase, ratepayers never have contributed to or paid for their development. As the California Public Utilities Commission recently explained in rejecting a similar proposal with respect to an electric utility:

> The name and reputation of a utility is not an asset to which ratepayers have a claim. Indeed, the Commission has never included good will in the rate base of a utility for ratemaking purposes. It follows that ratepayers have never had to pay through rates a return on the value of good will. Ratepayers have paid nothing for the enhancement of the utility's name and reputation. Those have been built by the management of the utility if they are of any value. (27 CPUC2d at 369.) We see no reason why we should change that conclusion.

Re San Diego Gas & Elec. Co., A. 94-11-013, D. 95-12-018 (Cal. PUC Dec. 6, 1995). This principle has led state commission after state commission to the same conclusion, rejecting royalty requirements. See note 20, supra. It is reflected in numerous judicial opinions which reverse administrative agency attempts to allocate gains on non-depreciable assets to ratepayers (even where those properties have appeared in the ratebase).[22] It is reflected in the Commission's own rules, which prohibit the consideration of non-ratebase intangibles in ratemaking decisions. See pp. 15-16, supra. And it is reflected in the Commission's consistent practice, which *never* has imposed a royalty payment for the use of a non-book, intangible asset. Ibid.

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[22]Ever since Board of Pub. Util. Comm'rs v. New York Tel. Co., 271 U.S. 23, 32 (1926), the rule has been that:

> Customers pay for service, not the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock.

And, while some courts have allowed agencies to require payment to compensate ratepayers for over-depreciated properties or assets purchased with ratepayer capital contributions, the courts repeatedly have rejected attempts to force shareholders to "purchase" from ratepayers assets that were not depreciated -- much less intangible "assets" that never even appeared on regulated books. For example, in Philadelphia Suburban Water Co. v. Pennsylvania Pub. Util. Comm'n, 427 A.2d 1244 (Pa. Commw. Ct. 1981), the court held that ratepayers were not entitled to share on gains where the asset was neither depreciated nor consumed. Id. at 1247-48. Case after case follows precisely the same course. See, e.g., Boise Water Corp. v. Idaho Pub. Utils. Comm'n, 578 P.2d 1089, 1093 (Idaho 1978) (similar result for non-depreciable asset); City of Lexington v. Lexington Water Co., 458 S.W.2d 778, 779 (Ky. Ct. App. 1970) ("Having contributed nothing to [the property's] acquisition and having acquired no interest therein, the ratepayers assumed no risk in its disposition whether it be profit or loss."); Kansas Power and Light Co. v. State Corp. Comm'n, 620 P.2d 329, 340 (Kan. Ct. App. 1980) (similar result); Washington Pub. Interest Org. v. Public Serv. Comm'n, 446 A.2d 28, 28, 31-32 (D.C. 1982) (affirming allocation of gains to shareholders where land was not depreciated and shareholders provided no capital); Maine Water Co. v. Pub. Utils. Comm'n, 482 A.2d 443, 448-49 (Me. 1984) (same); see also In re: Kansas City Power and Light Co., 75 PUR4th 1, 27-29, 1986 Mo. PSC LEXIS 32, *59-61 (1986) ("The argument for passing through the profit to the ratepayer is less persuasive in the case of nondepreciable property"); Order Instituting Rulemaking, 32 C.P.U.C.2d 233, 1989 Cal. PUC LEXIS 587, * 1, 104 P.U.R.4th 157 ("[F]or sales of utility assets . . . any gain on the sale should accrue to the utility shareholders, provided that the ratepayers have not contributed to capital and any adverse effects on the selling utility's remaining ratepayers are fully mitigated.").

At bottom, the APCC has proposed a "royalty" fee not to promote ratepayer welfare but rather to saddle RBOC PSPs with an artificial, incremental cost -- forcing them to increase their prices and rendering them less able to compete with the APCC's members. That is not protection against cross-subsidization. It is blatant, anticompetitive protectionist regulation that may promote the interests of the APCC's members, but ill-serves consumers (who end up paying higher rates for payphone service to cover these artificially-imposed cost increases) and the public interest the Commission is sworn to uphold.[23] Accordingly, the APCC's bid for a protectionist royalty imputation scheme should be rejected.

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[23]In addition, to the extent per call compensation is based on cost, the rate payable to RBOC PSPs (but not independent PSPs) would have to be increased to account for this additional if artificial cost.

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September 10, 1996

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of September, 1996, I caused copies of the Reply Comments of the RBOC Payphone Coalition to be served upon the parties listed on the attached service list by first-class mail, postage prepaid.

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